No. 15716

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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BEVERLY B. BISTLINE,

*Appellant*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

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# Brief of Appellant

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F. M. Bistline,

R. Don Bistline,

Attorneys for Appellant,

Pocatello, Idaho



GATEWAY PRINTERS—POCATELLO

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# TOPICAL INDEX

# TABLE OF AUTHORITIES CITED

## LAW REVIEW ARTICLES



## STATUTES



## ANNOTATIONS

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## JURISDICTION

This action is for the recovery of certain income taxes paid by appellant to appellee for the years 1947 and 1948. The Internal Revenue Bureau disallowed certain long-term capital gains claimed by appellant in her returns for those years and set up a tax deficiency by reason thereof. Appellant paid the taxes so assessed and thereafter filed a claim for refund which was disallowed after which appellant filed this suit. These facts appear in appellants complaint (Tr. page 3).

Federal Statutes conferring jurisdiction are:

28 USCA Sec. 1346: 68 Stat. 589;

28 USCA Sec. 7422; 68A Stat. 876.

## STATEMENT OF THE CASE

The main facts were stipulated by counsel (Tr. pp. 31-37). Briefly summarized the stipulation is to the effect that appellant's father and mother, F. M. and Anne Bistline, on July 1, 1947, by two gift deeds conveyed certain parcels of vacant lots in Pocatello, Idaho, to appellant, together with two parcels of improved property. The legal descriptions of the separate parcels appear on pages 31, 32 and 33 of the transcript. At the time appellant received this property she was 24 years old and employed full time as business manager of the Pocatello Transit Company, which operated buses in Pocatello.

During 1947 she made three sales of vacant lots: (1) 2 lots to Kenneth Draper; (2) 1½ lots to Thomas J. Coates; (3) 1½ lots to Albert Anderson. In 1948 four sales were made: (1) 4 lots to H. A. Peterson; (2) 61 Lots to Pocatello Heights, Inc., for apartment house sites; (3) 56 lots to Empire Investment Company for a subdivision development; (4) 1½ lots to Edward F. Brick. (Tr. pp. 34, 35). Said sales were respectively reported in her 1947 and 1948 income tax returns on a long-term capital gain basis. (End stipulation summary).

All the parcels in Blocks 2 through 9, Block 11, and Blocks 21 through 27 were raw, sagebrush land, or part of an exhausted gravel pit with holes as deep as fifty feet. All

this ground was inaccessible except for some improved dirt roads. Individual lots could not be identified without a survey. The streets were not graded or marked, there were no water lines, sewers or curbs and gutters serving any of these lots. (Tr. pp. 49, 54, 55, 63. Exhibit No. 1). Due to their condition no market for these lots for residential purposes existed. (Tr. p. 55).

The remaining parcels (16), except Block 44, were scattered town lots, and for the most part had graded streets and sewers, and in some instances, sidewalks, oiled streets, and curbs and gutters. Block 44 was of the same character as the area described in the preceding paragraph and was part of it except for a gravelled street on the west.

The seven sales were made in much the same manner in that in each instance the prospective purchasers checked the ownership of the property in the county records and upon finding that appellant owned same contacted appellant's father, F. M. Bistline, with regard to purchasing it without any activity on the part of appellant or her father with regard thereto (Tr. 41, 42, 43, 44, 46, 62). Prior to the conveyance of the property to appellant sales had been refused of lots for residential purposes in the area subsequently acquired by the Pocatello Heights Apartments, which was in a Class A residential Zone. (Tr. 43, 55).

On June 27, 1948, appellant and A. R. Spaulding were married. A decree of divorce was granted them September 1, 1949, dissolving the marriage. A joint income tax return

was filed for 1948 by appellant and her then husband. The property sold by appellant, the subject matter of this suit, was her separate property.

Trial was had wthout a jury and judgment rendered for the defendant from which this appeal is taken.

## QUESTION INVOLVED

The question involved is whether or not appellant is entitled to long-term capital gain treatment on the three real estate sales in 1947 and the four real estate sales in 1948.

## SPECIFICATION OF ERROR

The District Court erred in entering judgment denying appellant the right accorded by the Statutes in such cases made and provided to pay her income tax on one-half of the gain realized by her on each of the sales of land made in 1947 and 1948, for the reason that the evidence conclusively establishes that such property was not held by her primarily for sale to customers in the ordinary course of her trade or business.

## SUMMARY OF ARGUMENT

1. Where property is acquired by taxpayer and sales made with little or no activity on his part, the profits realized therefrom are entitled to capital gain treatment.

Camp vs. Murray, 226 F 2d 931;

Smith vs. Dunn, 224 F. 2d 353;

Martin vs. U. S., 119 Fed. Sup. 468;

McConkey vs. U. S., 130 Fed. Sup. 621;

Hebenstreit vs. U. S., 55-2 USTC p. 9571;

Adam Schantz Corp vs. Com'r., 11 TCM 424;

Loewenberg vs. Com'r., 7 TCM 702;

Kleberg, Est. of vs. Com'r., 5 TCM 858;

Ellis vs. Com'r., 13 TCM 15;

Three States Lumber Co. vs. Com'r., 158 F. 2d 61;

Guthries vs. Jones, 72 Fed. Sup. 784;

Storrow vs. U. S., 99 Fed. Sup. 672;

Frieda E. J. Farley, 7 T. C. 198;

Est. of Mackall vs. Com'r., 3 TCM 701;

Southern California Law Review Vol. 29, No. 1. December, 1955, p. 116.

46 ALR., 20, 623 ET. SEQ.

2. Where real estate is held as an investment, profit on the sale of such property is entitled to long-term capital gain treatment.

Lobello vs. Dunlap, 210 F. 2d, 465;

Goldberg vs. C. I. R., 223 F. 2d 709;

Malouf vs. Ridell, 52-1 USTC p. 9296;

Farry vs. C. I. R., 13 T. C. 8;

Jones vs. C. I. R., 1 TCM 816;

Miller vs. Com'r., 20 BTA 230;

Hutchinson vs. Com'r., 8 TCM 597;

Victory Housing vs. Com'r., 205 F. 2d 371;

Delsing vs. U. S., 186 F. 2d 59;

McGah vs. Com'r., 210 F. 2d 769;

Burkhard Invest. Co. vs. U. S., 100 F. 2d 642;

Fahs vs. Crawford, 161 F. 2d 315;

Harriss vs. Com'r., 143 F. 2d 279;

Boomhower v. U. S., 74 F. Supp. 997;

Dunlop vs. Oldham Lumber Co., 178 F. 2d 781;

Ross vs. Com'r., 227 F. 2d 265;

Collin vs. U. S., 57 F. Supp. 217;

McKay vs. Bowers, 53-2 USTC p. 9535;

Vaughn vs. Com'r., 7 TCM 288;

Fahs vs. Taylor 239 F. 2d 224;

E. R. Fenimore Johnson, 19 TC 93.
46 ALR. 2D 623 ET SEQ.

3. Where taxpayer received a tract of land by gift from father and devoted a relatively small amount of time to its supervision, and at no time held himself out as a dealer in real estate, he was entitled to long-term capital gain treatment on profits derived from sale of such land.

Sparks vs. United States 55 Fed. Supp 941.

4. Where taxpayers inherited property from their mother, and sales of 161 lots were made over a period of six years by their father on their behalf, without any effort on his or their part, the property was held to be capital assets and entitled to long-term capital gain treatment.

Gruy vs. Commissioner, 8 TCM 787.

FEDERAL STATUTES INVOLVED

INTERNAL REVENUE CODE (1939) Title 26, Section 117 (a) DEFINITIONS. As used

in this chapter (1) CAPITAL ASSETS.— The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include * * * property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business * * *.

(4) LONG-TERM CAPITAL GAIN. — The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income.

## ARGUMENT

It is appellants contention that the property in question was being held as an investment and that the three sales in 1947 and the four sales in 1948 do not constitute sufficient frequency and continuity to classify appellant as a dealer in real estate within the meaning of the statute.

AUTHORITIES: See cases cited under SUMMARY OF ARGUMENT

Paragraphs numbered 1 and 2.

Vol. 29, No. 1, Southern Cal. Law Review, Dec. 1955, page 116. Annotation 46 ALR 2D 623 ET SEQ.

Two special situations occur in this case. One has to do with a parent conveying property to a child, and the other has to do with a parent giving counsel and advice and assisting in handling sales.

The first of these situations is covered by the case of *SPARKS VS. U. S.*, 55 F. Sup. 941 (D. C. Ga.,). Here the father deeded by gift two subdivisions to his son in November, 1937. The father had previously platted the property and had even held an auction sale in an attempt to dispose of the lots. However, for a number of years before deeding to the son he had been inactive and no effort had been made to keep up the improvements. Quoting from the case:

> "Plaintiff's father was holding the property with the belief that it was steadily enhancing in value because it lay adjacent to Shirley Hills, a highly developed residential suburb of the City of Macon.

After the son acquired the property he made a sale of certain unsold lots; granted a 50-foot right-of-way for the purpose of a roadway, and at his own expense connected certain drives with the county highway, repaired the roads, paved one road, surveyed further roads and paid out approximately $3000 for such improvements and in addition conveyed two lots of the approximate value of $1500 for certain other improvements. In 1939 he was approached by certain parties who advised him that the Rental Housing Division of the Federal Housing Administration desired to have constructed in Macon a garden type apartment house under the FHA

insured loan plan, and that a representative of FHA had selected certain of his property for that purpose. The apartment was built resulting in a demand for more lots which he sold. In holding that plaintiff was entitled to long-term gain benefits, the court said:

> "When plaintiff originally acquired the lands from his father it was his purpose and intent to improve the same so as to enhance their ultimate value so as to enable him to make sufficient sales to liquidate the bank indebtedness, if that were possible. * * * While plaintiff had planned and hoped to make sales of lots or other portions of said lands for the purpose of liquidating the bank indebtedness, his *primary purpose* not only in going into the apartment house project, but in making other improvements shown by the evidence *was for the ultimate enhancement in value of the entire tract,* and plaintiff's activities were carried on with that in mind and with the view of making more readily salable some of the property in the Lone Oak Drive Subdivision and in the immediate vicinity of the apartment house for the purpose of liquidating the bank debt. (Italics supplied).

The other situation with regard to the parent counselling and assisting in the sales is the case of GRUY VS. COMMISSIONER, 8 TCM 787 (Texas 1949). In that case the taxpayers inherited the property involved from their mother, and at the time the sales were made they were college and high school students. The sales were all made by the tax-

payers' father on their behalf and were: 14 lots in 1939; 24 lots in 1940; 15 lots in 1941; 14 lots in 1942; 54 lots in 1953; 40 lots in 1944. Petitioners negotiated no sales nor made any effort to sell the lots. Civic leaders of the community interested in the town's growth urged the father to put on a selling campaign of the lots but he refused. He regarded them as a safe investment and was indifferent as to selling, and made no effort to make sales. The purchasers, unsolicited in each instance, went to the father and made offers to buy, and when he deemed the rice offered sufficiently attractive it was accepted. The lots were not listed for sale, nor advertised, nor was a "for sale" sign placed on them. No improvements were made on the lots by petitioners or their father. The court said with regard to the increase in sales activity:

> "The economic conditions produced by the war caused a great demand in 1943 and 1944 for the purchase of lots. The facts show that neither petitioners personally nor through their father were engaged in the real estate business, and the lots were not held primarily for sale to customers. The sales appear to have been essentially in the nature of a gradual and passive liquidation without 'extensive development' and 'sales activity'."

By comparison we have in the instant case only seven sales made in two years compared with 161 transactions in six years in the Gruy case, yet in that case the Tax Court held that the taxpayers were entitled to long-term capital gain benefits.

It is to be noted in the instant case that appellant's father regarded this property as a good investment and was not particularly interested in selling it (Tr. p. 62). No effort was made by appellant or any one for her, to list the property for sale, advertise it, or do anything to make it marketable, such as adding improvements. (Tr. page 46). When Mrs. Mitchell tried to purchase a building site in the area which was subsequently purchased by the Pocatello Heights, Inc., for an apartment project, she was refused. (Tr. p. 43).

Another case we wish to make special reference to is *Storrow vs. U. S.*, 99 F. Supp. 672 (1951) (S. D. Calif. C. D., U. S. D. Ct.). During the taxable year 1944 three sales were made by taxpayer by her trustee, California Trust Co. Seventeen lots were sold to one buyer in one transaction, one lot improved with a restaurant building was sold to the same buyer in another transaction, and in the third transaction, to a different buyer, taxpayer sold one parcel consisting of 11.44 acres of land. This case is as near to being on "all fours" with the instant case as any that have been cited. There are a few minor distinctions which should be pointed out: In the Storrow case the property was inherited, in the instant case it was a gift. Mrs. Storrow made her sales through a trustee whereas appellant made her own sales. From 1942 until her death in 1950 Mrs. Storrow suffered from strokes and diabetes and was confined to her bed, including 1944, the year in question, while in the case at bar appellant was well and employed by the Pocatello Transit Company. The California court held that taxpayer was entitled to long term capital gain on her real estate transactions, and we wish

to emphasize the point that the government did not appeal this decision. In our search of the cases we have noted that in each instance where the taxpayer has been allowed capital gain treatment on the sales of real estate the government has chosen not to appeal, which would indicate that taxpayers should be allowed the relief granted them by the law with regard to long term capital gain in cases such as the one here.

In our STATEMENT OF POINTS TO BE RELIED UPON BY APPELLANT (Tr. 73-77) five distinct points have been enumerated relating to the sales therein set forth. These are herewith presented in the order in which they appear:

1. The sales of 56 lots to the Empire Investment Company. This property was located in the undeveloped sagebrush and exhausted gravel pit area heretofore described. They were purchased by the Empire Investment Company for the purpose of developing a subdivision, which was subsequently developed at great expense and is known as "College Terrace." Mr. Rolland M. Smith, under whose guidance this subdivision was developed had been in the real estate business 15 years. He had developed nine subdivisions with an average of about 200 houses in each and had sold about 1,800 lots in such deals. He testified that this property, although so zoned, had no market value as residential lots. (Tr. p. 55).

We have made an intensive search for cases touching upon the point of unmarketable property being held for sale in the

ordinary course of the trade or business of a taxpayer, but have been unable to find any. In all the cases we have found where such a situation existed, we noted that the situation had been remedied by the taxpayer taking some steps to make the property marketable, and in the cases we have cited the court nevertheless held that the taxpayers were entitled to long-term capital gain benefits.

Sparks vs. U. S., Supra;

Gruy vs. Commissioner, Supra.

Cases cited SUMMARY OF ARGUMENTS, paragraphs I, II.

Therefore a question naturally arises: Where property is restricted to a specific purpose, residential in this instance, and no market exists for the lots in their then condition, how can it be construed that they were being held for sale in the ordinary course of the taxpayer's business?

2. The second point (Tr. 74) is with regard to the sale of Block 44, 36 and 27 and Lots 19 and 20 of Block 21 of Pocatello Townsite to the Pocatello Heights Apartment Corporation in one transaction. In connection therewith, we urge that the evidence shows that this property was not being held for sale in that attempts had been made to buy the same and sales were refused. (Tr. 43) and that this sale was made under very special circumstances which are set forth in the testimony of the witness O. R. Baum. (Tr. p. 37-40). Also, that the sale was made in the public interest,

and not because of any particular desire on the part of appellant to sell same.

We particularly call attention to the case of *Gruy vs. Commissioner,* supra, in support of our position on this point. This sale, like the sale to the Empire Investment Company falls into a distinct category, perhaps different somewhat from the five small sales, because the evidence clearly shows that this property was being withheld from the market with a view to possible future development. (Tr. page 62,) and should be given special treatment by the court.

3. The third point (Tr. p. 75) is with regard to the sales of 2 lots to Draper, 1½ lots to Coates, and 1½ lots to Anderson. In each of these cases the purchasers sought the lots. Quoting Albert Anderson (Tr. p. 44): "I happened to become interested in that lot because they were next door to me and I tried pretty near two years to get it and finally I got it. I first talked to F. M. Bistline about the lot about 15 years ago and it took pretty near two years before a sale could be made."

Also quoting Thomas J. Coates (Tr. p. 42): "During the year 1947 I inspected some lots on North 6th Avenue with the view to buying them. I don't recall the description now, and at the time I was inspecting the lot I didn't know the number, but I do know it was on 6th and Bridger. I went to the Court House and found out. After I went to the Court House I got in contact with the owner and they sent us to F. M. Bistline and subsequently a contract was signed and the sale made."

4. The fourth point (Tr. 76) is with regard to the sale of the four lots to H. A. Peterson and 1½ lots to Brick. These sales it is to be observed from the testimony of both Mrs. Peterson and Mr. Brick, were wholly unsolicited on the part of appellant or anyone on her behalf. The sales happened to go through the Smith-Marshal Agency, principally because its name had formerly been Bistline Realty Company, and not because of any listing of the lots with them. (Tr. p. 41, p. 44). At this point it might be well to mention the matter of a "for sale" sign having been placed on these lots by Wendell Marshall of the Smith-Marshall Agency. (Tr. 65). This was denied by Rolland M. Smith, the head of the firm (Tr. p. 58). If the sign ever was on the lots, there is no evidence that appellant ever authorized it or even knew it was there. Under the circumstances we feel that these sales fall into the same category as the sales under Point 3.

5. The fifth point (Tr. 76, 77) is the general issue raised by our assignment of error and the entire brief applies thereto.

We desire to draw the court's attention to the matter of their being a book in the office of Smith-Marshall Company, which the witness Marshall referred to as listings (Tr. p. 65). This list was there while F. M. Bistline was connected with the Bistline Realty Company, the predecessor of the Smith-Marshall Agency. It was not added to or kept current. (Tr. 65). Attempts to get listings by Mr. Marshall were unsuccessful (Tr. 66). The only one that he said he succeeded in getting was the 4 lots sold to Peterson, and that was after Peterson had contacted him with regard to

purchasing the lots. (Tr. 65, 66). But we want to particularly quote Mr. Marshall's testimony:

> "None of the lots that Mr. Smith and I bought from Beverly and you in what later became College Terrace Addition were in that book. And it did not contain a listing of any of the lots that the Simplot people bought in Pocatello Heights." (Tr. 66).

Also his statement: "Beverly never gave us any listings" (Tr. p. 65).

We are not unmindful of the holding of this court in the case of *Ehrman vs. Commissioner*, 120 F. 2d 607 (1941), for the reason that this is the main case the Trial Judge relied upon. However, we feel that the evidence in the instant case clearly does not bring it under the Ehrman rule, on account of the difference in the situations. In that case 186 lots were sold in the year 1935. The court avoids stating how many sales were made.

With regard to the *Ehrman* decision we call the court's attention to the article in Southern California Law Review, Vol. 29, No. 1, December, 1955, pages 120, 121 entitled "Capital Gains on Real Estate Subdivisions". We quote from it:

> "The net effect of the *Ehrman* decision was to make frequency and continuity of transactions the sole test of whether capital gains treatment is available. The court held that an individual with frequent and

continuous transactions is in business. Then on finding the individual in business it treats him as a "dealer" without regard to the fact that he has no established place of business and no regular employment in purchasing real estate and reselling it to customers. The result is that a person can have numerous *security transactions* during the year without losing the benefits of the capital gains provisions, whereas a person with an equal number of real estate transactions will be held to have ordinary income.

"Section 1237 which was added by the Internal Revenue Code of 1954 seems to be tailored to fit the Ehrman case and would have allowed capital gain treatment to taxpayers in that case had it been in effect at the time the sales were made. * * *

"The section appears to do little more than to preclude the Commissioner's use of evidence of subdividing and activity against the taxpayer in certain limited cases. It would seem that a taxpayer who has subdivided and sold land which he has held under five years, or which for some other reason does not qualify under section 1237, could still get capital assets treatment on the basis of case law if he were to take an extremely passive attitude toward the sales and turn all details over to an independent broker. In the Ninth Circuit the taxpayer would have to overcome the *Erhman* case, but by now a sufficient conflict has developed between the Fifth and Ninth

Circuits that he could probably carry his case to the Supreme Court in case of an adverse decision."

The author of that article in her conclusion observes: (Page 125);

"By resorting to some fairly complicated devices a taxpayer who has purchased land can assure that his gains on sale will be taxed as a low rate. Logically he should also be able to claim that he is entitled to capital gains treatment if he is not a 'dealer.'

"A taxpayer who has inherited land can obtain capital gains treatment more easily. If he is in the Ninth Circuit * * * he can pay his tax as on ordinary income and file a claim for refund and, if this is denied, sue in the Court of Claims which has held in favor of a taxpayer. He may be able to bring himself within the provisions of section 1237 so that evidence of subdivision and of activity incident thereto cannot be used to find that the gain is ordinary income. The last alternative is that if he is a Ninth Circuit taxpayer who has to contend with the *Ehrman* decision, he can show the errors in reasoning on which that decision is based."

## CONCLUSION

We have cited a number of reverse cases where land was sold at a loss under circumstances similar to the ones here, e. g., *Fahs vs. Taylor*, 239 Fed. 224 (5th) and the taxpayer was contending that he was in business and entitled to 100% ordinary losses. In such cases the Government would have none of it. They consistently have taken a position in such cases that they are capital losses. We would like to suggest to the court that before coming to a final conclusion that it assume that instead of appellant having made a profit, that she had taken a loss on each of these transactions. The rule should certainly be tested both ways.

In conclusion we submit that on the facts of the case and the law applicable thereto that appellant is entitled to a reversal with instructions that judgment be entered for her as prayed in her complaint.

Respectfully Submitted,

F. M. Bistline,

R. Don Bistline,

ATTORNEYS FOR APPELLANT.

Pocatello, Idaho.